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ResearchReport

Allco Finance Limited v. Klee

By: Mary Fitzpatrick, Associate Analyst
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Issue

This report summarizes the opinion of the Second Circuit Court of Appeals in *Allco Finance Limited v. Klee,* 861 F. 3d 82 (2d Cir. 2017). The case concerns Connecticut's (1) energy solicitations under PA 13-303 and PA 15-107 and (2) renewable portfolio standard. The Office of Legislative Research is not authorized to give legal opinions and this report should not be considered one.

Summary

In its decision, the court affirmed the lower court's dismissal of Allco's claims against Connecticut's Department of Energy and Environmental Protection (DEEP) and Public Utilities Regulatory Authority (PURA). The court found that the state's request for proposals (RFP) to procure renewable energy did not infringe upon the Federal Energy Regulatory Commission's (FERC) exclusive authority under the Federal Power Act to regulate the wholesale electric energy market. Among other things, the court noted that Connecticut's RFP program differed from the program struck down by the U.S. Supreme Court in *Hughes v. Talen* (2016) as it was not "tethered" to wholesale energy auctions regulated by FERC.

The court also dismissed Allco's claim that the state's renewable portfolio standard (RPS) violates the Commerce Clause of the U.S. Constitution. The court found that the burden imposed on interstate commerce by the program was not excessive when compared to its local benefits (e.g., Connecticut's need for a more diversified and renewable energy supply).

The plaintiff has appealed the case to the U.S. Supreme Court.

Energy Solicitations

Allco's complaints mainly concerned a 2015 request for proposals (RFP) conducted by the Department of Energy and Environmental Protection (DEEP). Through the 2015 RFP, DEEP solicited proposals as authorized under PA 13-303 (§§ 6 & 7) and PA 15-107 (§ 1). Both public acts allow the DEEP commissioner to solicit proposals from providers of specified energy sources, and, if proposals meet certain criteria, direct the electric distribution companies (EDCs, i.e., Eversource and United Illuminating) to enter into long-term agreements with providers for energy, capacity, or environmental attributes. Both acts also allowed coordination with other states. DEEP conducted the 2015 RFP as part of a multistate process (i.e., the "Three State RFP") with Massachusetts and Rhode Island. Documents related to the 2015 RFP are available here.

Allco argued that the solicitations violated the Federal Power Act (FPA), which gives the Federal Energy Regulatory Commission (FERC) exclusive authority to regulate the interstate wholesale electric energy market. The Public Utility Regulatory Policies Act (PURPA) creates an exception, allowing states to regulate wholesale sales of electricity made by "qualifying facilities" (QF, i.e., certain renewable generation facilities with less than 80 megawatts of capacity). The 2015 RFP was open to non-QF projects and Allco argued that the state violated the FPA by compelling EDCs to enter into contracts with non-QF facilities.

In its decision, the court affirmed the lower court's dismissal of Allco's claims, focusing on three issues to conclude that the 2015 RFP did not violate the FPA. First, the decision noted that while the statutes allow the DEEP commissioner to direct the EDCs to enter into long-term contracts for various resources from selected proposals (CGS § 16a-3j(g)), the RFP stated that it did not obligate an EDC to accept any bid and that winning bidders would enter into contracts with the EDC at the EDC's discretion (RFP, p. 5). Therefore, the court found that the RFP did not compel the EDC to sign contracts with winning bidders.

Secondly, the decision rejected Allco's argument that the RFP process was similar to a policy struck down by the U.S. Supreme Court in *Hughes v. Talen* (2016). One way FERC regulates the wholesale electricity market is by overseeing auctions and other market mechanisms administered by regional transmission operators. In *Hughes*, the court struck down an order in Maryland meant to encourage development of new in-state

Contract for Differences

In a contract for differences, a generator or other resource is given a specified price for its energy or capacity. It then sells power on the regional wholesale energy market.

The electric company compensates the generator for the difference between the price it received in the market and the price quoted in the contract (unless the market price is higher than the contract price, in which case the generator compensates the electric company).

generation capacity by requiring utilities to enter into a long-term contract for differences with providers for capacity. Because this arrangement would require the provider to participate in the regional transmission operator's capacity market but also guarantee the provider a price separate from the price produced by that market, the court found that Maryland's program disregarded an interstate wholesale rate required by FERC and thus was preempted by the FPA.

In the *Allco* decision, the Second Circuit noted that Connecticut's RFP program differed from Maryland's program in that it was independent from capacity or other wholesale energy auctions. The 2015 RFP directed EDCs to enter into bilateral contracts for selected proposals and subjected those contracts to review by FERC (RFP, p. 36). In *Hughes*, the Supreme Court limited its holding, stating that its opinion does not prevent states from encouraging certain generation as long as they do not condition payments on auction participation.

Finally, the Second Circuit court rejected Allco's general argument that the 2015 RFP did not comply with PURPA as it charged fees, excluded bids from QFs of under 20 megawatts, and directed utilities to enter into contracts with non-QF generators. The court held that the RFP was a permissible exercise of power granted to states by the FPA apart from the PURPA exception. The court also rejected Allco's argument that because the RFP would produce contracts that would increase the supply of electricity, it would cause wholesale prices to decrease and thus infringe on FERC's regulatory authority by affecting wholesale markets. The court held that such an incidental effect on wholesale prices is not regulation and thus does not infringe on FERC's jurisdiction.

Renewable Portfolio Standard

Allco's complaints also concerned Connecticut's renewable portfolio standard (RPS), which requires EDCs and competitive suppliers to procure a portion of their power from renewable and other clean energy resources. Companies can meet the RPS by directly contracting to buy renewable energy or buying RECs on the regional market. (For more information on the state's RPS, see OLR Report 2017-R-0103.)

Allco claimed that Connecticut's RPS violated the Commerce Clause by (1) discriminating against Allco's Georgia facility by not allowing its renewable energy credits (RECs) to count toward the EDCs' RPS requirements and (2) discriminating against Allco's New York facility by requiring it to pay transmission fees to sell RECs to Connecticut's EDCs.

Commerce Clause

The federal constitution gives Congress the authority to regulate interstate commerce. State statutes and regulations are occasionally challenged under the theory that they impose an unconstitutional burden on interstate commerce. This type of legal challenge to state regulation is often referred to as a "dormant commerce clause" case.

A state law or policy may be found to violate the dormant commerce clause if it (1) clearly discriminates against interstate commerce, favoring intrastate commerce or (2) does not discriminate, but has incidental effects on interstate commerce. Laws and policies that do not clearly discriminate but have such incidental effects are permissible unless the burden imposed on interstate commerce is clearly excessive in relation to local benefits, while laws that do discriminate face a more stringent level of scrutiny.

For the Georgia facility, the court agreed with the state's argument that its RPS program is nondiscriminatory. Connecticut's RPS program accepts RECs from within the region and contiguous regions. The court agreed with the state's argument that, as RECs produced by Allco's Georgia facility do not meet legal requirements of Connecticut's RPS program, the two types of RECs are different products. Therefore, the RPS program acts in a nondiscriminatory manner, treating different products differently.

The court further found that the burden imposed on interstate commerce by the program was not excessive when compared to its local benefits. Among other things, the court noted that Connecticut's need for a more diversified and renewable energy supply would not be served by RECs produced by Allco's Georgia facility as it cannot transmit its electricity into the ISO-New England region. It also found that Connecticut's RPS program serves the state's legitimate interest in promoting increased production of renewable power generation in the region, "thereby protecting its citizens' health, safety, and reliable access to power."

While Connecticut's RPS program allows RECs from facilities in adjacent control areas to count towards the state's requirements, facility owners must pay a fee to transmit their energy into the ISO-New England grid in order to sell their RECs to Connecticut utilities. Allco claimed that its New York facility suffered discrimination due to the obligation to pay these fees, in violation of the Commerce Clause. The court determined that Allco failed to demonstrate that the fees were anything more than use fees, similar to road tolls, that have been found permissible in other contexts. The court affirmed the lower court's dismissal of Allco's claim related to its New York facility.

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